No. 10594

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

WESTERN MESA OIL CORPORATION and EL SEGUNDO OIL COMPANY,

Appellants,

vs.

EDLOU COMPANY *et al.*, Landowners in El Segundo Community Lease No. Four-A; EDLOU COMPANY *et al.*, Landowners in El Segundo Community Lease No. Two-B; A. A. MCCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Four-A; A. A. MCCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Two-B; A. A. MCCRAY, WM. H. RAMSAUR and F. R. C. FENTON,

Appellees.

PETITION FOR REHEARING.

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Appellees.

PETITION FOR REHEARING.

Come now Western Mesa Oil Corporation and El Segundo Oil Company, appellants hereunder, and respectfully petition this Honorable Court for a rehearing of the issues involved in the above entitled appeal, based upon the following grounds:

Point I.

THE COURT'S DECISION MISINTERPRETS THE PLAN OF ARRANGEMENT AND GIVES TO IT A MEANING FOREIGN TO THAT WHICH WAS INTENDED BY THE DEBTOR. THE PLAN OF ARRANGEMENT CONTEMPLATED A DETERMINATION OF THE STATUS OF LANDOWNERS' ROYALTIES RATHER THAN A DEFINITION OF THEIR RIGHTS.

Point II.

THE PLAN OF ARRANGEMENT, AS CONSTRUED BY THE COURT'S DECISION, VIOLATES SECTION 366(3) OF THE BANKRUPTCY ACT OF 1938. THE COURT'S DECISION CONSTITUTES A DANGEROUS PRECEDENT BY HOLDING THAT THE DEBTOR, UNDER CHAPTER XI, MAY PREFER ONE GROUP OF UNSECURED CREDITORS OVER ANOTHER GROUP OF UNSECURED CREDITORS, EVEN THOUGH SUCH DISCRIMINATION IS NEITHER FAIR NOR EQUITABLE.

Point III.

THE EFFECT OF THE COURT'S DECISION IS TO HOLD THAT THE CREDITORS, TRUSTEE AND RECEIVER OF A DEBTOR ESTATE MAY BE ESTOPPED BY CONDUCT OF THE DEBTOR AFTER THE COMMENCEMENT OF THE BANKRUPTCY PROCEEDING FROM RAISING VALID OBJECTIONS TO THE ALLOWANCE AND PROVABILITY OF CLAIMS OF CREDITORS.

Point IV.

THE COURT'S DECISION OVERLOOKS THE VITAL FACT THAT, IRRESPECTIVE OF THE PROVISIONS OF THE PLAN OF ARRANGEMENT, THE RECEIVER AND CREDITORS WERE EXPRESSLY VESTED BY THE ORDER OF CONFIRMATION WITH THE RIGHT TO RAISE ANY OBJECTIONS TO THE ALLOWANCE OF THE CLAIM OF ANY CREDITOR.

Point V.

THE COURT'S DECISION CONFLICTS WITH ESTABLISHED LAW OF THE STATE OF CALIFORNIA KNOWN AS THE DOCTRINE OF *BOONE V. TEMPLEMAN.*

POINT I.

The Court's Decision Misinterprets the Plan of Arrangement and Gives to It a Meaning Foreign to That Which Was Intended by the Debtor. The Plan of Arrangement Contemplated a Determination of the Status of Landowners' Royalties Rather Than a Definition of Their Rights.

The underlying theory of the decision of this Honorable Court improperly assumes that the plan of arrangement in this case constituted an offer to the holders of landowners' royalties whereby the Debtor solicited acceptances from these persons on the promise that they would be paid in full if they consented to such plan of arrangement. Thus this Court in its opinion and immediately before quoting the paragraph of the plan that deals with the matter of landowners' royalties, says: "The debtor proposed a plan of arrangement *and to secure the consent of these unsecured claimants* the plan included the following provision: * * *."

The assumption is unwarranted by the record. At no time did the Debtor solicit consents from the holders of landowners' royalties, nor were consents ever filed by such holders. The holders of landowners' royalties were either (1) unsecured creditors affected by the plan, or (2) priority claimants who were required to be paid in spite of the plan. The plan called upon the bankruptcy court to *determine* whether the holders of landowners' royalties were in the one class or the other. The plan of arrangement did not *define* the status of these claimants. It merely called for the *determination* of their status. The decision of the Court thus serves the purpose of defeating one of the important objectives of the plan of arrangement, to wit:

the determination of the status of the claims of the holders of landowners' royalties.

This Court's decision is that the phrase "landowners' royalties which carry with them the right of forfeiture of the oil and gas leases" does not refer to an *acquired* right of forfeiture. In rejecting the contention of the appellants, the Court states that it considers the words "landowners' royalties" to mean "landowners' royalty agreements" and not the moneys paid under the agreements. No sound basis for this conclusion of the Court is afforded by the record. In effect the Court's decision serves as a rewriting of the plan of arrangement by the Court. Any doubt that the term "landowners' royalties" referred to royalty "payments" and not "agreements," is avoided by the sentence immediately following the one in question:

> "Where * * * the facts disclose * * * the landowners * * * have legally waived the right of forfeiture as to any of the *unpaid royalties,* the same will be * * *." [R. 81.]

Here the royalties are expressly referred to as unpaid royalties.

Why, then, was the particular language used? Inasmuch as it was conceivable that certain of the delinquent royalties did not carry with them the right of forfeiture, as, for instance, where notice of forfeiture as required by the lease had not been given, the plan provided that only as to such royalties which carried the right of forfeiture (obviously meaning perfected rights of forfeiture) and where there had been no waiver of such right, was payment to be made in full.

In interpreting the plan of arrangement, the Court should be governed by the rules that govern the interpretation of any writing. The Court should act *realistically*

and place itself as much as possible in the position of the parties themselves and interpret the writing in such manner as is most consistent with the actual facts surrounding its creation. When the plan of arrangement in this case was proposed, the Debtor was insolvent. Being insolvent, it was under a duty to be *just* to its creditors, and to refrain from affording one creditor an advantage over another creditor of the same class. The keynote of bankruptcy law is "Equity is equality." In a straight bankruptcy proceeding, the landowners' royalty holders were nothing else but unsecured creditors unless they had *acquired* the right of forfeiture and thus enabled themselves to lay claim to the title of the oil leases. Being insolvent, there was no reason why the Debtor should or could have been more generous to one group of creditors over another if in ordinary bankruptcy both groups would have occupied a position of parity.

In arriving at its decision, the Court appears to have been influenced by the use of the word "carry," and the Court makes the observation in its opinion that "it is only the agreements which could 'carry' the provisions respecting the right of forfeiture." It was unnecessary for the Court to speculate on this question. There were no royalty agreements involved, and the only forfeiture provisions involved were those that were incident to the oil and gas leases themselves. These leases contain forfeiture provisions on the non-payment of the monthly royalties, giving to the lessors the right to their forfeiture by a 90-day written notice followed by non-payment during the ninety days. If the Court places itself in the position of the parties herein, it will understand that the insolvent Debtor, being charged with a duty to prepare a plan of arrangement which would be fair, equitable and feasible, drafted the plan for the purpose of establishing a yardstick for

the measurement of the rights of certain of its creditors whose rights were uncertain. The Debtor determined that its stockholders had no equity, and that based upon the value of its assets, it could sell the same to a new corporation which would be willing to pay twenty cents on the dollar to the unsecured creditors and payment in full of such persons who were entitled to priority. The holders of landowners' royalties constituted a class of claimants who asserted right to payment in full because they claimed that they had the right to forfeit the leases. It was logical, then, that the Debtor in its plan of arrangement would say that it would pay in full such landowner royalty holders whose rights carried ("included" might have been a better word) the right of forfeiture, otherwise to treat such landowners' royalties in the position of unsecured creditors.

If the intention of the wording was such as is now attributed to it by this Court, then the language used was entirely unnecessary. It is conceded that *all* of the leases contained the same forfeiture provisions. If the language "landowners' royalties which carry with them the right of forfeiture" did not refer to an acquired right of forfeiture but merely to the existence of forfeiture clauses, then it was entirely unnecessary to have used the language at all because the Debtor certainly knew that *all* of the leases contained forfeiture clauses. Language contained in a document should be construed as having been used intentionally and purposefully. If intentional, it could have had but one meaning, and that is it was a reference to whether or not the right of forfeiture had been *acquired*. It was entirely conceivable to the Debtor at the time that some of the landowners' royalty holders might have acquired the right of forfeiture whereas others might not have acquired such right. It is inconceivable that the

parties using this language were merely referring to whether or not the leases contained forfeiture provisions.

To understand why the plan of arrangement referred to acts of waiver occurring *prior* to the commencement of the bankruptcy proceedings and did not refer to acts of waiver thereafter, the Court must take into consideration the rule that the date of the commencement of the bankruptcy proceedings is the date of cleavage, and all rights of the bankrupt and the trustee are measured as of the date of the commencement of the proceedings. Section 70 of the Bankruptcy Act defines the title of a trustee of an estate of a bankrupt as vesting "as of the date of the filing of the petition in bankruptcy or of the original petition proposing an arrangement or plan under this act * * *." The rights and powers of a trustee are determined by the status of the date of the commencement of the proceeding. (*Lockhart v. Garden City Bank & Trust Co.* (C. C. A. 2, 1940), 116 Fed. (2d) 658. It was logical, therefore, for the Debtor's plan to refer only to acts prior to the commencement of the bankruptcy proceeding.

This, however, did not serve to eliminate the question of acts of waiver that may have occurred subsequent to the commencement of the bankruptcy proceeding. This very Circuit has held that where a conditional sale vendor files and proves a claim in bankruptcy, he waives the right to reclaim the property. (*In re Pilsener Brewing Co.*, 79 Fed. (2d) 63.) By recognizing the continued existence of the leases in question through their acceptance of royalties and their failure to apply for the right to enforce a forfeiture, the holders of the landowners' royalties effected a waiver of such right. Cases supporting this contention are cited in our Opening and Reply Briefs.

POINT II.

The Plan of Arrangement, as Construed by the Court's Decision, Violates Section 366(3) of the Bankruptcy Act of 1938. The Court's Decision Constitutes a Dangerous Precedent by Holding That the Debtor, Under Chapter XI, May Prefer One Group of Unsecured Creditors Over Another Group of Unsecured Creditors, Even Though Such Discrimination Is Neither Fair nor Equitable.

The Court cites Sections 306, 351, 356 and 357 of the Bankruptcy Act as authority that an arrangement may give priority to one class of unsecured claims over another class of unsecured claims. We do not disagree with this conclusion, provided that the Court recognizes the effectiveness of subdivision (3) of Section 366, which provides that before the Court can confirm an arrangement it must be satisfied that the arrangement "is fair and equitable and feasible." The plan of arrangement may not give preference to one group of creditors over another unless there is substantial reason so to do. A plan which gives an advantage to one group of creditors over another "violates the principle of parity of treatment required by section 366(3)." (*Lane v. Haytian Corporation of America* (C. C. A. 2, 1941), 117 Fed. (2d) 216, 220.)

> "Beyond that is the question of unfair discrimination to which we have adverted. Compositions under chap. IX, like compositions under the old sec. 12, envisage equality of treatment of creditors. Under that section and its antecedents, a composition would not be confirmed where one creditor was obtaining

some special favor or inducement not accorded the others, whether that consideration moved from the debtor or from another. *Re* Sawyer (D. C.), 2 Low, Dec. 475, Fed. Cas. No. 12,395; *Re* Weintrob (D. C.), 240 F. 532, 39 Am. Bankr. Rep. 407; *Re* M. & H. Gordon (D. C.), 245 F. 905, 40 Am. Bankr. Rep. 301. As stated by Judge Lowell in *Re* Sawyer, *supra,* 'If a vote is influenced by the expectation of advantage, though without any positive promise, it cannot be considered an honest and unbiased vote.' That rule of compositions is but part of the general rule of 'equality between creditors' (Clarke v. Rogers, 228 U. S. 534, 548, 57 L. ed. 953, 959 S. Ct. 587, 30 Am. Bankr. Rep. 39) applicable in all bankruptcy proceedings. That principle has been imbedded by Congress in chap. IV by the express provision against unfair discrimination."

American United Mutual Life Ins. Co. v. City of Avon Park (1940), 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91.

(The reasoning applicable to Chapter *IX* is equally applicable to Chapter *XI.*)

The effect of the Court's decision now is to ignore the applicability of Section 366(3) and thus to give sanction to discriminating differentiations unauthorized by Chapter XI. We are confident that the Court will, upon giving additional consideration to the effect of its decision and the failure to consider Section 366(3), grant a rehearing to avoid the inequity of the present decision.

POINT III.

The Effect of the Court's Decision Is to Hold That the Creditors, Trustee and Receiver of a Debtor Estate May Be Estopped by Conduct of the Debtor After the Commencement of the Bankruptcy Proceeding from Raising Valid Objections to the Allowance and Provability of Claims of Creditors.

This Court's decision serves as a vehicle for a debtor, under Chapter XI, to deprive its creditors from their vested right of objecting to the allowance of the claims of creditors.

Objections to the allowance of claims are made under Section 57(f) of the Bankruptcy Act of 1938. This section is a part of Chapter VI of such Act. Section 302 provides that the provisions of Chapters I to VII, inclusive, of the Bankruptcy Act shall be applicable to proceedings under Chapter XI except in so far as they may be inconsistent with or in conflict with the provisions of such chapter. Section 57 is, therefore, a part of Chapter XI. See *Collier on Bankruptcy,* 14th Ed., pp. 973 to 976.

Bearing in mind that the effect of this Court's decision is to permit the insolvent Debtor to prevent its creditors from objecting to the allowance of the claims of certain unsecured creditors as priority claimants, we are faced with an upheaval of established principles of bankruptcy law.

It has been held that a bankrupt, being insolvent, should not be entitled to object to the allowance of claims of creditors.

> *Gregg Grain Co. v. Walker Grain Co.* (C. C. A. 5), 258 Fed. 156, cert. den. 262 U. S. 746, 43 S. Ct. 522, 67 L. Ed. 1212.

There appears to be some authority to the effect that the bankrupt, *in addition* to the creditors, may object to the allowance of claims. In no case have we found any indication that the bankrupt has as much as a right equal to the creditors to object to claims, much less a superior right, as appears to be the result of this Court's decision. In this case there was no trustee, but the receiver acted as the representative of the creditors. His functions were similar to those of a trustee. A trustee has almost an exclusive right to object to claims on behalf of creditors. Under Section 47(a)(8) of the Bankruptcy Act (which by virtue of Section 302 is made applicable to Chapter XI), a trustee (receiver in this case) is under a statutory duty to "examine all proofs of claim and object to the allowance of such claims as may be improper."

In this case the Court has shifted the right of objecting to claims from the real parties in interest, to wit: the creditors, to the Debtor. In this result, the decision becomes a precedent laden with danger.

No act of the Debtor, particularly after the commencement of the bankruptcy proceedings, should have the effect of estopping the receiver as the representative of the creditors from asserting any valid objection to the allowance of any claim. Thus, for instance, in the case of *In re Continental Engine Co.,* 234 Fed. 58 (C. C. A. 7), it was held that the valuation of a claim in a proceeding for adjudication "cannot estop the Trustee acting on behalf of all creditors or any non-assenting creditors from denying the validity and provability of * * * (the) claim." This view received the approval of the Circuit Court of Appeals for the Second Circuit. (*In re Matter of Brown,* 118 Fed. (2d) 198.) It has been held that the estoppel of the bankrupt does not serve to estop the trustee

in bankruptcy, a trustee in bankruptcy being estopped only when all of the creditors are estopped. (*Earhart v. Valerius* (D. C., Mo.), 25 Fed. Supp. 754.)

Can it be said that in its plan of arrangement the Debtor has divested the bankruptcy court of jurisdiction to determine the allowability of the claim of the appellees? The matter of determining the status of claims and protecting creditors from unfair discrimination amongst them in the distribution of an estate is exclusively the power of the bankruptcy court. (*Bankruptcy Act of 1938,* Sec. 57.) To say that the Court can be deprived of that power by an act of the Debtor, is to place a control in the hands of the Debtor whereby the essential jurisdiction of the bankruptcy Court is defeated. Under the authority of the leading case of *Isaacs v. Hobbes Tie & Timber Co.,* 282 U. S. 734, 51 S. Ct. 270, 75 L. Ed. 671, a procedural attempt upon the part of the Trustee was held to be futile in so far as it could have the effect of divesting the bankruptcy court of jurisdiction which is exclusive to it. Applying the same reasoning, the acts of the Debtor in this case should not be permitted to enable the Debtor to function in lieu of the Court in passing upon the considerations that determine whether or not a claim is entitled to priority. The United States Supreme Court in *Isaacs v. Hobbes Tie & Timber Co., supra,* made it clear that a trustee has no right to waive the jurisdiction of the bankruptcy court. By the same token, the Debtor in this case was powerless to divest the bankruptcy court of its jurisdiction.

POINT IV.

The Court's Decision Overlooks the Vital Fact That, Irrespective of the Provisions of the Plan of Arrangement, the Receiver and Creditors Were Expressly vested by the order of Confirmation With the Right to Raise Any Objections to the Allowance of the Claim of Any Creditor.

In the order of confirmation, the bankruptcy court below expressly provided that the bankruptcy court would determine what claims would be entitled to priority. [R. 97.]

The order of confirmation further provided "that the Debtor or any party in interest, including the new corporation, the El Segundo Oil Company, shall have the right to object to the allowance of any claims filed herein, and such claims so objected to shall participate in the revised plan of arrangement hereby confirmed only on the basis of the amount of such claims as may be finally allowed by this court." [R. 98.] If the Debtor actually had estopped itself from asserting as grounds of objection to the priority allowance of the claims of appellees any conduct of the appellees occurring subsequent to the commencement of the bankruptcy proceedings, certainly the creditors and the receiver still had the right to so object, and the order of confirmation included a confirmation of the continued existence of that right. The proceeding for the determination of the rights of the holders of landowners' royalties was brought on by the receiver and the Western Mesa Oil Corporation as an unsecured creditor. [R. 51.] The petition set up the matter of determining the rights of

landowners' royalties in the light of their acceptance of current royalty payments from the receiver.

> "In connection with the administration of the Debtor's estate and the consummation of the said revised plan of arrangement, it is necessary that the status and rights of the holders of the said unpaid landowners' royalties be determined by this Court. All current landowners' royalties under the said leases, arising since the commencement of this bankruptcy proceeding, have been paid." [R. 53.]

The question was raised as to whether or not this conduct that occurred subsequent to the commencement of the bankruptcy proceeding was properly in issue before the Referee, and the proceeding was tried on the theory that such conduct had been put into issue. [R. 165, 189, 218.] The Referee made findings with respect to such conduct. [R. 70.]

It should be noted also that the right of persons other than the Debtor to object to claims was recognized and affirmed by the plan of arrangement itself. Thus the plan also provided that:

> "If * * * there appear to be any objectionable claims filed, the Debtor, or any party in interest, including the new corporation, shall have the right to object to the allowance of the same, and such alleged creditors shall participate in the plan as confirmed, only on the basis of the amount of their claims as may finally be allowed by this Court." [R. 84.]

POINT V.

The Court's Decision Conflicts With Established Law of the State of California (Known as the Doctrine of Boone v. Templeman).

In California, it is well established that once there has been an acceptance of payment not made punctually, the right of forfeiture is suspended until restored by the giving of a specific notice of intention to enforce it thereafter.

Boone v. Templeman, 158 Cal. 290;
Stevenson v. Joy, 164 Cal. 279;
Hoppin v. Monsey, 185 Cal. 678;
LeBallister v. Morris, 59 Cal. App. 699;
Wetherby v. Sinn, 73 Cal. App. 98;
Pearson v. Brown, 27 Cal. App. 125;
Miller v. Modern Motor Car, 107 Cal. App. 42;
Lafoon v. Collins, 212 Cal. 750.

Viewing the Court's decision most favorably to the appellees, we cannot yet escape the fact that the Court's decision does violence to the foregoing rule. If the rights of the appellees included the right of forfeiture, it was only a suspended right of forfeiture which could be restored only in the manner described in the foregoing cases. The record discloses no restoration of these suspended rights. Therefore, appellees could not possibly qualify as holders of landowners' royalties "which carried the right of forfeiture."

Conclusion.

The payment to one class of creditors of 20% of their claims in the face of the payment to another class of creditors with no greater legal rights of 100% of their respective claims, is an obvious discrimination in favor of the latter against the former group. This result was unintended by the Debtor in this case. But even if the Court does not adopt our construction of the plan, and whether the Debtor is estopped or not, the creditors discriminated against should certainly have the right to object to the discrimination. The effect of the decision of this Court has been to eliminate the element of fairness required by Section 366(3) of the Bankruptcy Act as an essential feature of a plan of arrangement and serves to permit a Debtor to estop the real parties in interest, the creditors, from asserting their vested rights. It permits the debtor to deprive the Court of its exclusive jurisdiction to pass upon the allowance of claims of creditors. We respectfully urge this Court to reexamine its decision and grant a rehearing thereof.

Respectfully Submitted,

Raphael Dechter and

Harry A. Pines,

Attorneys for Appellants.

Certificate.

We do hereby certify that, in our judgment, the foregoing petition for rehearing is well founded and we do further certify that said petition is not interposed for the purpose of delay.

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